BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RICHARD M. AND)
BEVERLY BERTOLUCCI)

For Appellants: Cyrus A. Johnson
Attorney at Law

For Respondent: James W. Hamilton
Acting Chief Counsel

James C. Stewart
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Richard M. and Beverly Bertolucci against a proposed assessment of additional personal income tax in the amount of $2,616.62 for the year 1971.

The sole issue presented on appeal is whether a certain cash withdrawal made by Richard M. Bertolucci (hereafter appellant) from his wholly owned corporation constituted a taxable dividend.

Appellant is the sole shareholder of Bertolucci Body and Fender Shop, Inc. In October 1971, appellant withdrew over $32,000 from the corporation, and used the money as a down payment for a parcel of real estate located one block from the corporate office.

Near the close of 1973, respondent commenced an audit of the 197 1. tax returns of both appellant and his controlled corporation. As a result of the audit, respondent determined that the withdrawal in question represented a corporate dividend taxable to appellant as ordinary income. Accordingly, respondent issued a proposed assessment of additional personal income tax for 1971. Appellant protested the proposed assessment on the basis of his contention that the corporate advance was in fact a loan which he at all times intended to repay.

The record on appeal indicates that the withdrawal in question was evidenced by an unsecured demand note which, apparently, was executed on December 31, 1973. As of that date, appellant had not made any payments of principal or interest on the purported loan. Subsequently, in 1974 and 1975, appellant made payments to the corporation totaling $11,200. Of that amount, appellant represented that $5,000 was the repayment of principal and $6,200 was the payment of interest on the alleged indebtedness.

Whether a withdrawal of corporate funds by a shareholder represents a taxable dividend or a nontaxable loan is a question of fact which must be resolved in light of all the facts and circumstances surrounding the transaction. (Berthold v. Commissioner, 404 F. 2d 11.9; Elliott J. Roschuni, 29 T. C. 1193, aff'd per curiam, 271 F. 2d 267, cert. denied, 362 U. S. 988 [4 L. Ed. 2d 1021]; Appeal of Robert B. and Joanna C. Radnitz, Cal. St. Bd. of Equal. , May 6, 197 .. The controlling or ultimate determination in a particular case is whether, at the time of the withdrawal, the parties in interest genuinely intended that the funds be repaid. (Estate of Taschler v. United States, 440 F. 2d 72; Atlanta Biltmore Hotel Corp., T.C. Memo. , Sept. 19, 1.963, aff'd, 349 F. 2d 677; Appeal of Jack A. and Norma E. Dole, Cal. St. Bd. of Equal., Nov. 6, 1970.) However, with respect to a shareholder who withdraws funds from his wholly owned corporation, the objective manifestations of the parties' intent must be viewed with special scrutiny. (Elliott J. Roschuni, supra, 29 T. C. at 1201; Harry Hoffman, T. C. Memo., August 2, 1967.)

Appellant contends that the following factors conclusively establish that the withdrawal in question constituted a loan from his corporation; treatment of the withdrawal as a loan on the corporate books of account, the execution of a note evidencing the loan, appellant's ability to repay the withdrawn funds at any time, and appellant's payments of principal and interest on the loan. However, while we recognize that these factors, if proven, may tend to support appellant's position, we cannot conclude on the basis of the record before us that the withdrawal represented a bona fide loan.

As sole shareholder of the controlled corporation, appellant had the ability to manipulate its affairs to obtain permanent use of the withdrawn funds without the formal declaration of a dividend by using the guise of a loan from the corporation. The record on appeal indicates that the corporation made no formal dividend distribution during 197 1.. Thus, we cannot attach much significance to the treatment of the withdrawal as a loan on the corporate books of account. (See Ogden Co., 50 T. C. 1000, 1005, aff'd, 412 F. 2d 223; Elliott J. Roschuni, supra; Katherine R. Lane, T. C. Memo. , August 28, 1969.) Also, the record on appeal indicates that appellant did not execute the promissory note, or make any payments of principal or interest on the purported loan, until after respondent had commenced its audit of appellant's 1971 tax return. This fact weakens these factors as persuasive evidence of a preexisting intention to repay the withdrawn funds. (See Gurtman v. United States, 237 F. Supp. 533, 536, aff'd per curiam, 353 F. 2d 212; George R. Tollefsen, 52 T. C. 67 1, 680, aff'd, 431 F. 2d 51 1.) Furthermore, the fact that the promissory note was a demand instrument with no fixed schedule for repayment decreases its significance as evidence of genuine indebtedness.

(See Bayou Verret Land Co. v. Commissioner, 450 F. 2d 850, 857; see also Estate of Taschler v. United States, supra, 440 F. 2d at 76.) Finally, although appellant contends that at all times he intended, and was financially able, to repay the withdrawn funds, he has offered no explanation for the delay in repayment.

Appellant also suggests that the withdrawal cannot be characterized as a dividend because it was made to enable him to purchase a parcel of real property in anticipation of the possible necessity to relocate the corporate office. We agree that the withdrawal of corporate funds by a shareholder for a corporate or business purpose is not equivalent to a dividend where the shareholder is clearly acting as an agent of the corporation. (See 1 Mertens, Law of Federal Income Taxation § 9.23.) However, where the withdrawal places corporate funds in the shareholder's absolute control, and subject to his unrestricted discretion as to their use, the mere assertion of a vague or indefinite intention to use the funds for a future corporate purpose is not sufficient to negate a finding that the withdrawal represents a dividend. (See Nasser v. United States, 257 F. Supp. 443, 447.) In the instant case, appellant used the withdrawn corporate funds to purchase property in his own name. Title to the property was not transferred to the corporation, and appellant reported income and deductions with respect to the property on his personal income tax return.

The burden of proving that the withdrawal of funds from his wholly owned corporation was in fact a loan, and not a taxable dividend, rests upon appellant. (Gurtman v. United States, supra, 237 F. Supp. at 535; Appeal of Gordon A. and Zelda Rogers, Cal. St. Bd. of Equal., May 7, 1968.) After a careful assessment of the record, we are of the opinion that appellant has not met his burden.

Accordingly, we must sustain respondent's action in this matter.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor, Appeal of Richard M. and Beverly Bertolucci

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Richard M. and Beverly Bertolucci against a proposed assessment of additional personal income tax in the amount of $2,616.62 for the year 1971, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of May, 1976, by the State Board of Equalization.

William M. Bennett, Chairman

George R. Reilly, Member

Richard Nevins, Member

____________________, Member

____________________, Member

ATTEST: W. W. Dunlop, Executive Secretary